

AGREEMENTS

Partnership Agreements

Why a general partnership relying on the Partnership Act 1890 default rules is exposed, and what a written agreement should settle on profit shares, capital, retirement and dissolution.

A partnership exists with or without a document

Two or more people carrying on a business together with a view to profit are in partnership, whether or not they have signed anything. Many general partnerships start informally, for example a couple of professionals who share premises and costs, or family members who farm together. If there is no agreement, the Partnership Act 1890 fills the gap with default rules.

Those rules were written for a different era, and they rarely match what the partners assume. The most important is that partners are personally liable for the firm's debts, jointly and severally (section 9 of the 1890 Act). A creditor can pursue any one partner for the whole amount, not just their share.

What the default rules provide

In outline, and subject to a partnership agreement saying otherwise, the Act provides that (section 24):

- profits and losses are shared equally, whatever the capital put in or the time worked
- no partner is paid a salary
- no interest is paid on capital, but a partner is entitled to be indemnified by the firm for expenses properly incurred
- every partner may take part in management
- ordinary matters are decided by a majority, but changing the nature of the business, or admitting a new partner, needs everyone's consent
- there is no power to expel a partner unless the agreement gives one

Where this leaves the partners

A partner who works 60 hours a week takes the same share as one who works ten. A partner who wants out may be able to end the partnership by giving notice if there is no fixed term, which can dissolve the firm without anyone else's agreement (section 26). And the death or bankruptcy of a partner can end the partnership unless the agreement provides otherwise.

A common trap

Many partnerships assume that because one partner brought in the clients or the capital, they will receive more. Unless the agreement says so, they will not.

Key points

- A partnership can exist without any paperwork.
- Partners are personally liable for firm debts, not just their own share.
- Default rules share profit equally and give no power to expel.
- Without agreed terms, a partner's departure can force dissolution.
- A written agreement is the cheapest protection a partnership can buy.
- An LLP is a different structure with different rules. See the separate guide.

What a written agreement should settle

- **Profit and loss shares.** Fixed percentages, a formula based on work and capital, or a mix. Say when and how shares are reviewed.
- **Capital.** How much each partner contributes, whether it earns interest, and when it is repaid. Distinguish capital from current accounts and drawings.
- **Drawings and tax.** How much can be taken on account, and how tax on each partner's share is funded. Each partner is taxed personally on their share of the profits, whether or not they draw it.
- **Management and decisions.** Who decides what, and which decisions need unanimity, such as borrowing, new premises or admitting partners.
- **Duties.** The time each partner commits, outside interests, and a duty not to compete with the firm.
- **Retirement and expulsion.** Notice periods, how an outgoing partner's share is valued and paid, and grounds for expulsion.
- **Death, illness and bankruptcy.** Whether the firm continues, and how the partner's estate is paid out.
- **Restrictive covenants.** Reasonable limits on competing and on approaching clients and staff after leaving.

Before you start

- Who are the partners, and who might join?
- How is profit shared, and who funds the capital?
- What happens if a partner dies or wants out?
- Is there a retirement age or a notice period?
- How is the firm valued, and by whom?
- Would an LLP or a company suit better?

Dissolution

The agreement should say how the firm may be wound up, who realises the assets, how the proceeds are divided and who looks after the records.

Without it, the Act sets the order in which debts and capital are paid, and a partner who disagrees can ask the court to intervene (section 35).

Keeping the agreement alive

Review the agreement when partners join or leave, when profit shares change, or when the business changes direction. Partnership tax returns, bank mandates, insurance and any property documents should all reflect who the partners now are.

Moving to an LLP or company

Partners who want limited liability can move the business into an LLP or a company. Plan the move: assets and contracts must be transferred, clients and banks told, and tax consequences considered with the firm's accountant. The partnership agreement should be wound up or replaced by a members' or shareholders' agreement, and the outgoing arrangements for retired partners dealt with in writing. Keep the old agreement and accounts, since liabilities from the partnership period do not disappear.

How MTM can help

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Practices often raise partnership agreements for clients who have outgrown an informal arrangement. We draft the agreement from your client's instructions, advise on the structure alongside you, and prepare any related documents. If the partners decide to incorporate, we can also help form the LLP or company and move the business across. Tax and valuation advice stays with you.